

## **DEPARTMENT OF FINANCIAL INSTITUTIONS POLICY STATEMENT ON PAYDAY LENDING AND CHECK DECEPTION & CHECK FRAUD**

Indiana's Small Loan Act ("SLA") was enacted in 2002 after significant administrative, judicial, and legislative debate. The Indiana legislature ultimately made the determination that, under the totality of the circumstances, it was appropriate to legalize and regulate the controversial loan product. The SLA was enacted, and subsequently amended in 2004, only after significant negotiation and compromise regarding consumer protection provisions. Among the most important points of debate were the issues of the "debt treadmill" and creditor collection practices.

Members of the staff of the Indiana Department of Financial Institutions ("DFI") participated in an advisory role in the drafting of both the initial and amended language. The DFI staff has a clear understanding of the intent of the legislature regarding this act. This is particularly true with respect to the practice of payday lenders seeking treble damages and/or attorney fees by claiming they have been defrauded by defaulting borrowers. While the SLA includes a reference to the availability of fraud and deception damages in the payday loan context, its scope and application were intended to be very narrow.

Please note that Indiana courts have repeatedly afforded state agencies "great weight" in interpreting the statutes and regulations with which they are charged with enforcing. This was most recently reinforced in *Citizens Action Coalition of Indiana, Inc. v. Northern Indiana Public Service Company*, 804 N.E.2d 289 (Ind. Ct. App. 2004). The DFI is the regulatory agency responsible for interpreting IC § 24-4.5-7-409, and agency management is confident that its interpretation of the statute is reasonable.

It is important to recognize that Indiana's criminal Check Deception and Check Fraud statutes were designed to protect merchants who unwittingly accept bad checks from consumers. Recovery under these statutes is their only recourse. In the payday loan setting, the check represents collateral/security for a loan, and not payment for goods or services. Additionally, the creditor retains the recourse of suing on the loan contract for recovery. Included in recovery on the contract are the total amount due, one NSF fee of \$20 if contracted for, court costs, and post judgment interest at 8% if awarded by the court. Treble damages and/or attorney fees are not allowed.

The SLA, particularly as amended as of July 1, 2004, provides for a fee structure that recognizes the high-risk nature of, and anticipated bad debt experience associated with, the loan product. The legislative intent was not to also provide payday lenders with the ability to collect treble damages and attorney fees based on bad check charges, simply because their borrower defaulted on the loan contract.

The issue of the applicability of Check Deception and/or Check Fraud to payday loan transactions implicates various statutes. Following is an analysis of these statutes as they apply to the payday loan industry:

Within the SLA, IC § 24-4.5-7-409 provides that IC § 35-43-5 (forgery, fraud, and other deceptions) and IC § 34-24-3 (treble damages allowed in certain civil actions by crime victims) apply to small loans only when a check or ACH authorization is used to defraud another person.

IC § 34-24-3-1 provides for the award of, among other things, treble damages, costs, and reasonable attorney fees, if a person suffers a pecuniary loss as a result of a violation of, among other statutes, IC § 35-43.

Three sections of IC § 35-43-5 warrant analysis with respect to their applicability to the payday loan business. IC § 35-43-5-8 describes the crime of Fraud on a Financial Institution. Small loan licensees are not defined, for purposes of Title 35 generally, or this particular section, as financial institutions. Financial institutions are defined once in Title 35, within the same chapter as the Fraud on Financial Institutions section. IC § 35-43-5-12 (Check Fraud) defines a financial

institution as “a state or federally chartered bank, savings bank, savings association, or credit union.” Since payday lenders are not financial institutions, as defined, for purposes of Title 35, attempts to seek damages under this section represent a misapplication of law.

IC § 35-43-5-5 deals with Check Deception, which is generally a Class A Misdemeanor. Subsection (a) includes a requirement that a person must issue or deliver a check “knowing” that it will not be paid upon presentment. Subsection (c) notes that the fact that payment of the check was refused is *prima facie* evidence that the person “knew” the check would not be paid. However, with respect to the payday loan industry, it is essential to note that subsection (f) states that check deception has not occurred when the payee on the check knew that the issuer had insufficient funds *or* that the check was postdated. Given that these provisions of subsection (f) describe the typical payday loan transaction, these transactions, by their nature and structure, do not constitute violations of IC § 35-43-5-5.

IC § 35-43-5-12, noted earlier, describes the criteria necessary to establish Check Fraud, which generally constitutes a Class D felony. In order to recover under this section, a plaintiff must, by a preponderance of the evidence, demonstrate that a person, with *intent* to defraud, issued a check or ACH: 1.) *knowing* that it would not be paid upon presentment; 2.) using false or altered *evidence of identity or residence*; 3.) using a false or altered account number; or 4.) using a false or altered check or ACH instrument. Some have argued that the closing of an account, or the stopping of a payment, after the issuance of a check, meets the *intent* and *knowing* tests described above. Certainly a strong argument for fraud can be made for a check that is written on an already-closed account, but the burden of proving the issuer’s intent and knowledge otherwise will be fact specific. Among factors to be considered would be the timing of the check issuance as compared with the stop payment or account closing, as well as consideration of prior business dealings with the issuer. Further, to invoke this section for a claim based on the provision by the customer of false personal information requires proof that false or altered *evidence of identity or residence* was provided by the customer.

Based on the forgoing, it is the position of the DFI that the practice of seeking damages based on IC § 35-43-5-5 or 8 is in contravention of IC § 24-4.5-7-409, and the pursuit of this practice by a licensee under the SLA could result in revocation of the license. Further, in order to monitor future compliance with IC § 24-4.5-7-409, and as part of the required record retention requirement for licensees under IC § 24-4.5-3-505(1), the DFI requires that any fraud complaint seeking treble damages and/or attorney fees by invoking other statutes, provide sufficient detail to allow for an analysis by DFI staff of the appropriateness of the complaint. The DFI believes this requirement is consistent with the notice pleading rules in Indiana. Specifically, in *Grzan v. Charter Hospital of Northwest Indiana*, 702 N.E.2d 786 (Ind. Ct. App. 1998), the court stated that “the issue of whether a complaint sufficiently pleads a certain claim turns on ‘whether the opposing party has been sufficiently notified concerning the claim . . . so as to be able to prepare to meet it.’” The DFI also requires the retention of all documents related to the lender’s collection efforts.

IC § 24-4.5-7-409 also provides that IC § 26-2-7 (penalties for stopping payments or permitting dishonor of checks and drafts) applies to small loan accounts when a check or ACH authorization is used to defraud another person. It is essential to note, however, that IC § 26-2-7-4 states that a person must be found liable under another applicable law before liability arises under this chapter.

Any questions regarding this policy should be directed to Mark B. Tarpey, Supervisor of Consumer Credit Division, Indiana Department of Financial Institutions, 30 South Meridian Street, Suite 300, Indianapolis, IN 46204 (317) 232-3955.